

Utilities Privatization Regulated Considerations



Presented by Steve Allenby
United Financial
September 28-29, 2004

Doing Business as a Regulated Utility

World Wide Energy Conference
2004

- **Many Masters**
 - Corporate/Risk Management
 - Federal and State Regulation
 - Accounting
 - National Codes and Regulations
 - Regional Organizations – ISOs, Electric Reliability Councils, Mutual Aid Agreements
- **Strive for a Highly Reliable System**
 - Initial Construction
 - Service Restoration
- **Unique Way to Calculate Regulated IOU Prices**



Calculating Regulated IOU Utility Prices

World Wide Energy Conference
2004

• Cost of Service Pricing

- Expenses, including the cost of debt, are not marked up
- Only shareholder equity used to buy “Used and Useful Assets that serve customers (Ratebase)” may earn a return
 - The Rate of Return is set by Public Utility Commissions (PUCs)
- PUCs “**allow**” rates that provide utilities with an “**opportunity**” to earn their allowed returns
 - Returns on Ratebase are not guaranteed

<u>Expenses</u> <u>Revenue</u>	<u>+</u>	<u>Return on Ratebase</u>	<u>=</u>	<u>Utility</u>
\$5 <i>(debt)</i>		$((.5 \times 8\%) + (.5 \times 12\%) \times \$10)$	$=$	\$6 <i>(equity)</i>

Absorbing a DOD Utility System

World Wide Energy Conference
2004

- **Precedent for Purchasing & Absorbing Small Utility Systems**
 - Regulatory
 - No subsidy
 - Charge new customers applicable cost of service rates
 - Special contracts are common
 - Financial/Accounting
 - Ratebase assets
 - Operations
 - Identical treatment
 - Service Restoration
 - Follow utility procedures



Third Party Financing

World Wide Energy Conference
2004

- **System Purchase is not Financed**
 - Credit to government utility bill
- **System Upgrades Might be Financed**
 - Often relatively small
- **Financing Structure - Assign Govt. Payments to Financier in Exchange for Lump Sum Payment**
 - Need High Probability Payment will be made
 - No performance offsets
 - Requires special government contract provisions



Implications of Regulated IOU Financing

World Wide Energy Conference
2004

- **Taxes**
 - Lump sum may be taxed as income in year received
- **Tradition - All Purchased Systems are Treated the Same**
 - Accounting, Operations, Service Restoration
 - Regulators are comfortable with utility system acquisition model
 - Government systems are small compared to utility system

Implications of Regulated IOU Financing

World Wide Energy Conference
2004

- **Difficult to Accommodate Third Party Financing Model**
 - Utility pricing formulas based on Cost of Service
 - Third party financing = no rate base
- **Service Restoration**
 - If privatized system is not absorbed in traditional manner, PUC may ask that utility to treat it blow the line
 - Different service restoration priority for below the line customers?

Summary

World Wide Energy Conference
2004

- **Financed Amounts Are Relatively Small**
- **Taxes May Eliminate Interest Rate Benefit**
- **Altering The Historic Model Is Extremely Difficult**
 - Rate Making
 - Cost of Service Model is the Standard
 - Keep Accounting Simple
 - Regulatory
 - Operations
 - Service Restoration



Contact Information

World Wide Energy Conference
2004

**Steve Allenby
United Financial
52 Main St, PO Box 637
Proctor, Vermont 05765
P- (802)459-9900
F - (802-459-9901
sallenby@unitedfinancial.com**